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AZ CORP COMMISSION
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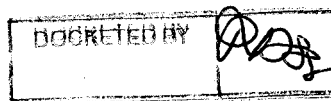
Samuel T. Miller
Staff Attorney
Air Force Utility Law Field Support Center
139 Barnes Drive Ste 1
Tyndall AFB FL 32403

Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, AZ 85007-2927

Arizona Corporation Commission

DOCKETED

JAN 18 2012



Re: Docket No. E-01345A-11-0224

Dear Madam or Sir:

Enclosed please find enclosed the original and 13 copies of the Testimony of Dr Larry Blank on behalf of Federal Executive Agencies in Support of the Settlement Agreement, for filing in the above-captioned case.

Thank you for your assistance in this matter.

Sincerely,

Samuel T. Miller
Staff Attorney
Air Force Utility Law Field Support Center

Attach:

Copy of Testimony of Dr Larry Blank

BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS:

Gary Pierce, Chairman
Bob Stump
Sandra D. Kennedy
Paul Newman
Brenda Burns

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA PUBLIC SERVICE COMPANY FOR A
HEARING TO DETERMINE THE FAIR VALUE
OF THE UTILITY PROPERTY OF THE
COMPANY FOR RATEMAKING PURPOSES, TO
FIX A JUST AND REASONABLE RATE OF
RETURN THEREON, AND TO APPROVE RATE
SCHEDULES DESIGNED TO DEVELOP SUCH
RETURN.

)
) DOCKET NO. E-01345A-11-0224
) **FEDERAL EXECUTIVE AGENCY'S**
) **NOTICE OF FILING**
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)

The Federal Executive Agencies (FEA), hereby provide notice of filing the Testimony in
Support of Proposed Settlement Agreement of Larry Blank in the above referenced matter.

Dated this 13th day of January, 2012.



KAREN S. WHITE
US AIR FORCE
UTILITY LAW FIELD SUPPORT CENTER
139 Barnes Dr
Tyndall AFB FL 32403
(850) 283-6348

A copy of the foregoing was mailed/*emailed on
January 17, 2012 to:

Lyn Farmer, Chief Administrative
Law Judge*
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Meghan H. Grabel*
Thomas L. Mumaw*
PINNACLE WEST CAPITAL
CORPORATION
P.O. Box 53999 ms 8695
Phoenix, AZ 85072-3999

Daniel Pozefsky, Chief Counsel*
RUCO
1110 W. Washington, Ste 220
Phoenix, AZ 85007

Timothy Hogan*
ARIZONA CENTER FOR LAW IN THE
PUBLIC INTEREST
202 E. McDowell Road
Ste 153
Phoenix, AZ 85004
Attorney for Western Resource Advocates
and Southwest Energy Efficiency Project

David Berry
WESTERN RESOURCE ADVOCATES
PO Box 1064
Scottsdale, AZ 85252-1064

Michael M. Grant*
GALLAGHER & KENNEDY, P.A.
2575 East Camelback Road
Phoenix, AZ 85016-9225
Attorneys for Arizona Investment Council

Gary Yaquinto*
ARIZONA INVESTMENT COUNCIL
2100 North Central Ave Ste 210
Phoenix, AZ
85004

Kurt J. Boehm*
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Ste 1510
Cincinnati, OH 45202
Attorneys for The Kroger Co.

C. Webb Crockett*
Patrick J. Black*
FENNEMORE CRAIG
3003 North Central Avenue, Ste 2600
Phoenix, AZ 85012-2913
Attorneys for Freeport-McMoRan
and AECC

Cynthia Zwick*
1940 E. Luke Ave
Phoenix, AZ 85016

Barbara Wyllie-Pecora
14410 W. Gunsight Dr.
Sun City West, AZ 85375

Michael A. Curtis*
William P. Sullivan*
Melissa A. Parham
CURTIS, GOODWIN, SULLIVAN,
UDALL & SCHWABB, P.L.C.
501 East Thomas Road
Phoenix, AZ 85012-3205
Attorneys for the Town of Wickenburg and
Town of Gilbert

Jeffrey W. Crockett*
BROWNSTEIN, HYATT, FARBER
SCHRECK, LLP
40 N. Central Ave., 14th Floor
Phoenix, AZ 85004
Attorney for Arizona Association of
Realtors
7321 N. 16th Street
Phoenix, AZ 85020

Michael W. Patten*
ROSHKA DEWULF & PATTEN PLC
One Arizona Center
400 E. Van Buren, Suite 800
Phoenix, AZ 85004
Attorney for Tucson Electric Power Co.

Bradley Carroll*
TUCSON ELECTRIC POWER CO.
One South Church Ave., Suite UE201
Tucson, AZ 85701

Janice Alward, Chief Counsel
Legal Division*
ARIZONA CORPORATION
COMMISSION
1200 West Washington Street
Phoenix, AZ 85007-2927

Nicholas J. Enoch*
Attorney For IBEW 387, 640,769
Lubin & Enoch, P.C.
349 North Fourth Ave.
Phoenix, AZ 85003

Steve Olea, Director
Utilities Division*
ARIZONA CORPORATION
COMMISSION
1200 West Washington
Phoenix, AZ 85007-2927

ARIZONA REPORTING SERVICE INC.
2200 N. Central Ave., suite 502
Phoenix, AZ 85004

Jeff Schlegel*
SWEEP Arizona Representative
1167 W. Samalayuca Drive
Tucson, AZ 85704-3224

Stephen J. Baron
Consultant for The Kroger Co.
J. Kennedy & Associates
570 Colonial Park Drive, Suite 305
Roswell, GA 30075

Greg Patterson*
Attorney for Arizona Competitive Power
Alliance
Munger Chadwick
2398 E. Camelback Rd. Suite 240
Phoenix, AZ 85016

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS:

Gary Pierce, Chairman
Bob Stump
Sandra D. Kennedy
Paul Newman
Brenda Burns

IN THE MATTER OF THE APPLICATION OF)
ARIZONA PUBLIC SERVICE COMPANY FOR A)
HEARING TO DETERMINE THE FAIR VALUE)
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RETURN THEREON, AND TO APPROVE RATE)
SCHEDULES DESIGNED TO DEVELOP SUCH)
RETURN.)
)

DOCKET NO. E-01345A-11-0224

**PREFILED TESTIMONY
IN SUPPORT OF PROPOSED SETTLEMENT AGREEMENT**

OF

LARRY BLANK

ON BEHALF OF

THE FEDERAL EXECUTIVE AGENCIES

January 18, 2012

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I. IDENTIFICATION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.

A. My name is Larry Blank. My business address is Tahoeconomics, LLC, 2533 North Carson St., Suite 3624, Carson City, NV 89706. My email address is LB@tahoconomics.com.

Q. WHERE ARE YOU EMPLOYED?

A. I am currently an Associate Professor of Economics and the Associate Director with the Center for Public Utilities in the College of Business at New Mexico State University ("NMSU"). For the purposes of this proceeding, I am engaged through *TAHOEconomics*, LLC, ("Tahoe"), a Nevada-registered consulting firm I founded in 1999, and for which I serve as principal. Tahoe specializes in most policy and ratemaking facets of regulated utility industries. The expert opinions expressed herein are my own and nothing in this testimony necessarily reflects the opinions of NMSU.

Q. ARE YOU THE SAME LARRY BLANK WITH PRE-FILED TESTIMONY IN THE EARLIER PHASES OF THIS CASE?

A. Yes.

II. PURPOSE AND SUMMARY

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. I am testifying on behalf of the Federal Executive Agencies ("FEA") in support of the Proposed Settlement Agreement ("the Agreement") executed by most of the parties to this proceeding and filed by Staff on January 6, 2012. As a general observation, the

1 Agreement is a very well-balanced attempt to address all the issues in this case, is clearly
2 in the public interest, and should be approved by the Commission. Although I will leave
3 it to the Company, Staff, and other parties to address all details of the Agreement, herein
4 I specifically address the Rate Case Stay Out provision, the Lost Fixed Cost Recovery
5 ("LFCR") mechanism, and the significant change in rate design for the large general
6 service customer classes and their exemption from the LFCR mechanism.

7 **Q. PLEASE SUMMARIZE THE REMAINDER OF YOUR TESTIMONY.**

8 A. I will specifically explain why the resolution of the following issues is just, reasonable,
9 and in the public interest:

- 10 1. A moratorium on base rate changes preventing any base rate increase prior to a
11 future date is a common provision for a rate case settlement, serves to protect
12 customers from risk related to base cost increases, and does not limit Commission
13 flexibility to pursue important electricity policy matters through a rulemaking
14 proceeding and/or a tariff rider as the need may arise under special circumstances.
- 15 2. To create an incentive for the successful implementation of energy efficiency
16 ("EE") and distributed generation ("DG") programs, the Agreement requires APS
17 to implement a targeted fixed cost recovery approach known as a Lost Fixed Cost
18 Recovery ("LFCR") mechanism (see Sections 9.1 – 9.6 of the Agreement). This
19 approach is far superior to the decoupling mechanism proposed by the Company
20 in its application. In addition to the LFCR mechanism, the Agreement continues
21 to support the EE shared net benefits performance incentives (Section 9.14(b) of
22 the Agreement), which places Arizona ahead of the curve nationally in terms of
23 creating incentives for APS implementation of EE programs.

1
2 3. The Agreement would significantly alter the rate design for the large general
3 service customer classes by substantially increasing the demand charges above
4 those proposed by APS in its application (as reflected in Attachment K to the
5 Agreement). This constitutes a significant shift in fixed cost recovery away from
6 the energy charges to the demand charges and, therefore, greatly reduces the risk
7 associated with reduced energy consumption and fixed cost recovery. This
8 substantive change in rate design greatly supports the exemptions from the LFCR
9 mechanism in Section 9.7 of the Agreement.

10 **III. RATE CASE STAY OUT PROVISION**

11 **Q. BASED ON YOUR EXPERIENCE, HAVE YOU SEEN PROVISIONS SIMILAR**
12 **TO THE FOUR YEAR MORATORIUM ON RATE INCREASES IN THE**
13 **PROPOSED SETTLEMENT AGREEMENT?**

14 A. Yes. I know of many rate case settlement agreements in which the utility agreed to not
15 file a rate case within two or three years. This type of provision is common.

16 **Q. IN YOUR OPINION, IS A FOUR YEAR MORATORIUM PREVENTING BASE**
17 **RATE INCREASES IN THE PUBLIC INTEREST IN THIS CASE?**

18 A. Yes. The Company has agreed to it and the customers will benefit from the stability in
19 rates over the next four years. Because Company management has a fiduciary
20 responsibility to their shareholders, they would not have agreed to this provision if it was
21 not in the best interest of their shareholders when combined with the other provisions in
22 the Agreement. Therefore, I see no reason why it is not in the public interest.

1 Q. DOES THE RATE CASE STAY OUT PROVISION PREVENT THE ADOPTION
2 OF IMPORTANT POLICY MEASURES DURING THIS PERIOD?

3 A. No. The Commission is free to investigate necessary electric industry policy changes
4 through rulemaking proceedings.

5 Q. DOES THE RATE CASE STAY OUT PROVISION PREVENT THE
6 IMPLEMENTATION OF TARIFF RIDERS SHOULD THE NEED ARISE?

7 A. Although I am not an attorney, I do not think so. For good cause and should the need
8 arise because APS was ordered and/or authorized to incur new costs (possibly in response
9 to a new rulemaking), I believe the Commission has the authority beyond this Settlement
10 Agreement to approve the implementation of a new tariff rider and, of course, the
11 existing tariff riders will continue to function. As an additional safeguard, paragraph 21.3
12 explains that neither this agreement or any portion thereof shall be stated or relied upon
13 as precedent in any future proceeding and, furthermore, the last sentence of paragraph
14 19.1. states: "Nothing in this provision is intended to limit the Commission's ability to
15 change rates at any time pursuant to its lawful authority."

16 IV. THE LOST FIXED COST RECOVERY MECHANISM

17 Q. DO YOU CONSIDER THE LFCR MECHANISM TO BE AN IMPROVEMENT
18 OVER THE DECOUPLING PROPOSED BY APS IN ITS APPLICATION?

19 A. Yes. This approach is far superior to the decoupling mechanism proposed by the
20 Company in its application. The Company's proposed decoupling mechanism would
21 have resulted in an over-correction for fixed cost recovery by failing to remove the large
22 amount of fixed costs recovered through the fixed monthly basic and demand charges.

1 Additionally, the proposed mechanism did not account for the significant differences in
2 rate design across rate classes.

3 **Q. DOES THE LFCR SOLVE THE INCENTIVE PROBLEMS ASSOCIATED WITH**
4 **ENERGY EFFICIENCY PROGRAMS?**

5 A. Yes. When it comes to energy efficiency programs and electric utilities, incentives or
6 costs created for the utility may be described as a three-legged stool. First, the utility
7 must be allowed to recover direct expenses incurred to implement and manage energy
8 efficiency programs. Second, energy efficiency programs should cause lost revenues and
9 unrecovered fixed costs in between general rate cases when those fixed costs are
10 recovered through the kWh energy charges. Third, energy efficiency programs may
11 cause foregone future capacity investments and, hence, create an opportunity cost related
12 to the future foregone return on equity. As stated in a recent *Electricity Journal* paper,
13 “[a] regulatory regime that ensures recovery of all three cost categories is analogous to a
14 three-legged stool in terms of creating a stable environment for electric utilities to pursue
15 energy efficiency in good faith.”¹ With this Settlement Agreement, Arizona will now
16 have all three legs of this “stool” in place. The LFCR addresses the second category of
17 cost, and with the continued energy efficiency performance incentives in the form of
18 shared net benefits (Agreement at 9.14(b)), the third category of cost is covered.
19 Therefore, the “stable environment” in terms of energy efficiency program incentives will
20 now be established for APS. Arizona will now be well ahead of the national curve on
21 energy efficiency programs.

¹ Larry Blank and Doug Gegax, “Objectively Designing Shared Savings Incentive Mechanisms: An Opportunity Cost Model for Electric Utility Efficiency Programs,” *The Electricity Journal*, Vol. 24, Issue 9, November 2011.

1 **Q. WOULD REVENUE DECOUPLING ADDRESS THE SAME INCENTIVE**
2 **PROBLEM RESOLVED BY THE LFCR?**

3 A. In terms of energy efficiency programs, yes, but general revenue decoupling causes an
4 unnecessary shift in risk away from the utility onto customers, because unlike the
5 targeted approach of the LFCR, revenue decoupling causes changes in customer billing
6 for reasons beyond lost fixed cost recovery due to EE programs. For example, revenue
7 decoupling would impose variation in customer billing due to weather fluctuations,
8 economic cycles, and any other factor causing change in revenue streams. Furthermore,
9 the design of the revenue decoupling mechanism proposed by APS in its application is
10 not the proper way to design decoupling and was flawed for all the reasons I stated in my
11 November 18, 2011, prefiled testimony. The Settlement Agreement and the LFCR
12 greatly corrects those problems and is far superior to what was originally proposed. The
13 LFCR in the Agreement is a good example of the potential benefit of settlement
14 discussions on very technical matters.

15 **Q. HAVE YOU WORKED ON THE DESIGN OF A MECHANISM SIMILAR TO**
16 **THE LFCR MECHANISM IN ANY OTHER JURISDICTION?**

17 A. Yes. I analyzed and testified on the design of a LFCR mechanism implemented by
18 Entergy in Arkansas. The LFCR proposed here for APS is very similar to the Arkansas
19 mechanism.

V. LARGE CUSTOMER RATE DESIGN AND THE LFCR MECHANISM

Q. PLEASE EXPLAIN THE RATE DESIGN CHANGES FOR THE LARGER CUSTOMERS PROPOSED IN THE AGREEMENT RELATIVE TO THE RATE DESIGN IN THE APS APPLICATION?

A. The Agreement significantly changes the rate design for the large customer classes by moving fixed cost recovery away from the kWh energy charges and substantially increasing the (ratcheted) kW demand charges. This change in rate design significantly reduces the risk of lost fixed cost recovery due to possible energy (kWh) reductions. As an example, the increases in the demand charges for the E-34 Extra Large General Service class, relative to those proposed by APS in its application, are very substantial as shown in the following table.

Demand (kW) Charges for the E-34 Extra Large GS Class				
Voltage	APS Application Rates per kW	Settlement Rates per kW	Settlement Increase	Percent Increase
Secondary	\$16.646	\$19.930	\$3.284	19.7%
Primary	\$15.687	\$18.649	\$2.962	18.9%
Transmission	\$10.914	\$12.278	\$1.364	12.5%
Military Ded. Feeder	\$11.749	\$13.392	\$1.643	14.0%

These substantial increases in the demand charges greatly shield APS from risk associated with possible energy (kWh) reductions due to energy efficiency.

Q. WHY IS IT PROPER TO NOT APPLY THE LFCR TO THE LARGE GENERAL SERVICE CUSTOMERS?

A. Section 9.7 of the Agreement creates an LFCR exemption for large general service rate classes. This exemption is proper for the reasons stated in my November 18 prefiled

1 testimony and the exemption is even more important given the substantive change in rate
2 design and higher demand charges in the Agreement as discussed above. Grouping these
3 large customers with other customer classes under the LFCR would cause unjustified
4 shifts in fixed cost recovery away from those other customer classes onto the large
5 customers as more fully explained in my November 18 prefiled testimony.

6 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

7 **A.** Yes, thank you.